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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 894

TENNESSEE PRODUCTS & CHEMICAL CORPORATION,
PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law (R. 22a–29a)[1] and the memorandum opinion of the district court (R. 49a–55a) are reported at 199 F. Supp. 885. The *per curiam* opinion of the court of appeals (Pet. 7–8) is reported at 297 F. 2d 529.

JURISDICTION

The judgment of the court of appeals was entered on January 4, 1962. (Pet. 9.) The court of appeals entered an order denying a petition for re-

[1] Record references are to the appendix to the petitioner's brief filed in the Court of Appeals.

hearing and amending its *per curiam* opinion on February 13, 1962. (Pet. 9.) The petition for a writ of certiorari was filed on April 20, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, in holding that the petitioner was not entitled to a bad debt deduction in 1942 or in 1946 because the alleged debt had been automatically cancelled in 1940, the courts below gave proper recognition to state court proceedings which had recognized *pro forma* the existence of the debt in connection with the administration of the debtor's estate.

CONSTITUTION AND STATUTES INVOLVED

Constitution of the United States of America:

ARTICLE IV.

SECTION 1. Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof.

28 U.S.C.:

SEC. 1738. STATE AND TERRITORIAL STATUTES AND JUDICIAL PROCEEDINGS: FULL FAITH AND CREDIT.

* * * * *

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States

and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

* * * * *

(k) [As amended by Sec. 124(a), Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 113, Revenue Act of 1943, c. 63, 58 Stat. 21] *Bad Debts.*—

(1) *General rule.*—Debts which become worthless within the taxable year; or (in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. * * *

* * * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

STATEMENT

W. J. Cummins was the chairman of the board of the petitioner corporation at an annual salary of $36,000. Frederic Leake was the corporation's president and general manager. (R. 22a.)

On March 16, 1931, the corporation's executive committee of which Cummins was also chairman, determined that in view of heavy potential losses by the corporation, the president should have the power to cut salaries, except that some employees, including Cummins, having heavy fixed expenses, would be allowed to overdraw up to the amount of their original salary, and would then owe the amount of such overdrafts to the corporation until they had repaid them (R. 24a) "or until it was credited back to them upon the resume of good business." In accordance with this arrangement, Cummins incurred a net overdraft of $75,267.40. (R. 23a–24a.)

On February 24, 1936, Cummins died, and Frederic Leake, president of petitioner, was granted letters of administration by the County Court of Davidson County, Tennessee. Cummins' estate did not exceed $10,000 in value and was insolvent. On April 1, 1937, the petitioner filed a claim against the estate for $75,267.40. (R. 25a.) As administrator of Cummins' estate, Leake filed no exception to the petitioner's claim. The county court did not pass upon the merits of the petitioner's claim nor did it adjudicate its validity under the laws of Tennessee. It merely approved *pro forma* the administrator's *pro rata* payment of a part of the petitioner's claim. In 1942 the petitioner received $745.76 from Cummins' estate, and deducted the balance of $74,521.64 as a bad debt. The petitioner received an additional dividend of $487.10 from the estate in 1946. (R. 25a–26a.)

The district court found that the agreement of March 16, 1931, under which the petitioner was to

debit Cummins' account if he overdrew his reduced salary, did not give rise to an immediately enforceable debt against Cummins since Cummins was not required to repay the petitioner until the petitioner had shown that it had continued in a poor business condition over a reasonably long period of time. The district court further found, in any event, that any debt evidenced by Cummins' overdraft was to be extinguished upon the occurrence of a condition subsequent, that is, the return of good business conditions, and that such conditions within the intendment of the agreement of March 16, 1931, returned in 1940. Therefore, there was no debt in existence in 1942 for which petitioner could take a bad debt deduction. (R. 25a, 27a). In fact the petitioner itself on its 1942 income tax return stated that Cummins' obligation was "Considered worthless prior 1942." (R. 26a.)

The court of appeals affirmed *per curiam*, holding that the facts as found by the trial judge and the inferences drawn therefrom were correct, and his legal conclusions sound. (Pet. 7–8.)

ARGUMENT

All of the cases with which the petitioner here alleges a conflict are distinguishable; the constitutional issue asserted does not exist; and review by this Court is unwarranted.

The decision of the district court, affirmed *per curiam* by the court of appeals, involves simply an interpretation of what a prior state court decree held. The district court specifically recognized that it was bound by the state court adjudication insofar as the

state court could or did genuinely adjudicate the rights of the petitioner and the Cummins' estate at the time of the administration of the estate. (R. 53a–54a.) Thus the petitioner errs in asserting that the district court and the court of appeals failed to give effect to the principle of *Life Insurance Co. v. Bangs*, 103 U.S. 780, holding that a judgment is conclusive not only as to defenses actually asserted against a claim, but also as against defenses which might have been asserted but were not. Recognizing the principle the district court here merely interpreted what the state court held.

We note further that the present case involves no question of *res judicata* or full faith and credit. Unlike this case, *Life Insurance Co. v. Bangs, supra*, involved litigation between the same parties who had previously litigated the question. Likewise *Davis v. Davis*, 305 U.S. 32, and *Mills v. Duryee*, 7 Cranch 481, each involved a second round of litigation between the same parties in a new jurisdiction, thus raising a question of full faith and credit. In *Frooler v. Helvering*, 291 U.S. 35, a controversy, like the present one, between the government and a taxpayer, in which the taxpayer was asserting the binding effect of a prior state court decree involving the interpretation of a trust, this Court said (p. 43):

> Obviously that decree had not the effect of *res judicata*, and could not furnish the basis for invocation of the full faith and credit clause of the Federal Constitution in the present case.

Petitioner also errs in asserting a conflict with *Blair v. Commissioner*, 300 U.S. 5; *Helvering v.*

Rhodes' Estate, 117 F. 2d 509 (C.A. 8th); and *Goodwin's Estate* v. *Commissioner*, 201 F. 2d 576 (C.A. 6th). All of these were cases in which state courts had previously adjudicated property rights, and those adjudications were held to be conclusive when it came to applying federal tax law in subsequent litigation. Obviously this was not done on any theory of *res judicata* or full faith and credit. *Freuler* v. *Helvering*, *supra*. Rather it was done on the theory that the determination of property rights was a proper function of the state courts, and when bona fide litigation in those courts had established such rights, the tax law would be applied accordingly.[2]

In the present case, the district court found that the state probate court neither passed upon the merits of the petitioner's claim against W. J. Cummins' estate nor adjudicated its validity under the laws of Tennessee. On the contrary, the district court found that the state probate court merely approved *pro forma* the *pro rata* payment by the administrator of Cummins' estate of a part of the petitioner's claim.

[2] It is significant that each of these cases made a special point of noting that the state court litigation constituted a genuine determination of those property rights in an adversary proceeding or in a proceeding which was not otherwise collusive or fraudulent. While neither court below relied upon it, we note that here the administrator of Cummins' estate against which the petitioner corporation made its claim in the state court was also the president of the petitioner corporation. The record is devoid of evidence that he ever conveyed to the state court his peculiar knowledge of the condition attached to Cummins' alleged debt—a condition which could automatically cancel Cummins' debt when the petitioner's business arrived at a certain level of prosperity—or that the other creditors of Cummins' estate had knowledge or the means to acquire knowledge of this significant condition.

(Finding 19, R. 26a.) Moreover, the trial court further concluded that the question of whether the petitioner's claim against Cummins (asserted by the petitioner to have been reduced to judgment by the order of the state court) was subject to be defeated by the condition subsequent set forth in the agreement of March 16, 1931, was not before the state court in the probate proceedings and further that the question was not adjudicated either expressly or impliedly therein. (R. 54a.) The court of appeals held that the facts as found by the trial judge and the inferences drawn therefrom were correct and not clearly erroneous.

The courts below correctly recognized as a matter of law that they would be bound by the state court's adjudication of the property rights of the petitioner and the Cummins estate if such rights had actually been adjudicated. Whether or not the courts below correctly interpreted this particular state court decree is not a question of general importance justifying the consideration of this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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